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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1956

No. — 631

BILL CORBETT, *Petitioner*

v.

UNITED STATES OF AMERICA, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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DECEMBER, 1956.

INDEX

	Page
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutes Involved	2
Statement of the Case	3
The Government's Case	4
1. Evidence Relating to Rental Income	5
Allowances	5
Unreported Income	8
Restorations to Income	8
2. Financial Statements	10
3. Summaries and Computations	11
Petitioner's Defense	15
Reasons for Granting the Writ	18
1. The Improper Summaries and Computations	19
2. The Improper Use of Financial Statements	24
Conclusion	28
Appendix A	29

Citations

Cases:

Bernstein v. *United States*, 234 F. 2d 475 (C.A. 5, 1946) cert. den. Oct. Term, 1956, No. 393	23
Costello v. *United States*, 350 U.S. 359 (1956)	23
Cwach v. *United States*, 212 F. 2d 520 (C.A. 8, 1954)	28
Despiau v. *U. S. Casualty Co.*, 89 F. 2d 43 (C.A. 1, 1937)	28
Dillard v. *United States*, 141 Fed. 363 (C.A. 9, 1905)	28
Eggleton v. *United States*, 227 F. 2d 493 (C.A. 6, 1955), cert. den. Oct. Term, 1956, No. 116	21
Friedberg v. *United States*, 348 U.S. 142 (1954)	18, 20, 22, 25

Page

Gold v. *United States*, Oct. Term, 1956, No. 137 . . . 21
Hartman v. *United States*, 215 F. 2d 386 (C.A. 8, 1954) . . . 27, 28
Holland v. *United States*, 348 U.S. 121 (1954) 18, 24, 25
Lloyd v. *United States*, 226 F. 2d 9 (C.A. 5, 1955 . . . 27
Nye & Nisson v. *United States*, 336 U.S. 613 (1949) . . . 27
Schmeider v. *Barney*, 113 U.S. 645 (1885) . . . 21
Shanahan v. *Southern Pacific Co.*, 188 F. 2d 564 (C.A. 9, 1951) . . . 28
Smith v. *United States*, 348 U.S. 147 (1954) . . . 19, 25
Steele v. *United States*, 222 F. 2d 628 (C.A. 5, 1955) . . . 23
United States v. *Altruda*, 224 F. 2d 935 (C.A. 2, 1955) . . . 23
United States v. *Calderon*, 348 U.S. 160 (1954) . . . 19, 25
United States v. *Johnson*, 319 U.S. 503 (1943) . . . 18, 20, 22, 24
United States v. *Ward*, 169 F. 2d 460 (C.A. 3, 1948) . . . 21
U. S. Chemicals Co. v. *Carbide Corp.*, 315 U.S. 678 (1942) . . . 21
Winans v. *New York & Erie R. Co.*, 62 How. 88 (1858) . . . 21

Statutes:

26 U.S.C. Section 145(b) . . . 2
28 U.S.C. Section 1254(1) . . . 2

Treatises:

3 Wigmore, Evidence (3d Ed., 1940), Sections 1020-1022 . . . 28

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v.

UNITED STATES OF AMERICA, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The Petitioner, Bill Corbett, prays that a Writ of Certiorari issue to the United States Court of Appeals for the Ninth Circuit.

Opinions Below

The District Court for the Western District of Washington entered no opinion. The opinion of the Court of Appeals (R. 1168) is not yet reported and is printed as Appendix A to this Petition, *infra*, pages 29-35.

Jurisdiction

The judgment of the Court of Appeals was entered November 14, 1956 (R. 1174). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

Questions Presented

1. Whether a conviction for income tax evasion can be based upon accountants' summaries and computations which contain opinions and conclusions as to the evaluation of lay testimony and which include computations essential to the Government's case are not based upon evidence in the record.

2. Whether in a prosecution for income tax evasion where net worth is not in issue the Government can introduce defendant's extrajudicial statements of net worth for the sole purpose of inflaming the jury by persuading it that some of the statements are false.

Statutes Involved

The statute involved in this case is former 26 U.S.C. Section 145(b) [now 26 U.S.C. Section 7201] which provides:

> Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and upon conviction thereof, be fined not more than $10,000 or imprisoned for not more than five years, or both, together with the costs of prosecution.

Statement of the Case

Petitioner was indicted on four counts for income tax evasion for the calendar years 1945, 1946, 1947 and 1948 respectively (R. 3-5). Count Four for the 1948 was dismissed by the Court at the close of the Government's case (R. 827). The jury acquitted Petitioner on Count Three for 1947 and found him guilty on Counts One and Two for 1945 and 1946 (R. 13). Petitioner was sentenced to two and one-half years on each count, the sentences to run consecutively, and was fined $5,000 on each count, together with costs (R. 17-18). The judgment and sentence of the District Court was affirmed by the Court of Appeals (R. 1174).

This is not a net worth case. The Government relied upon proof of specific items of unreported income. Specifically, for the years 1945 and 1946 the Government relied upon proof of unreported income from room rentals of the Claremont Hotel, owned by Petitioner, between July 1, 1945 [1] and December 31, 1946. The theory of the Government's case was that rental income was reduced on Petitioner's books, and hence not fully reported, by the entry of fictitious "allowances" in guests' accounts, and that some rental income was never entered on the books, and hence not reported.[2] This theory the Government supported by (1) documentary and testimonial evidence relating to rental income which failed to establish a deficiency in reported income for any one of the taxable years in question, (2) various statements of net worth made by the defendant which disclosed nothing about his income, reported

[1] Prior to July 1, 1945, the Claremont Hotel was owned by a corporation, all or most of the stock of which was held by Petitioner (R. 775, 863).

[2] The Government also claimed as unreported income for 1945 the sum of $295 representing salary checks of one employee who testified that she endorsed the checks back to Petitioner but who was not sure that she had never received any of the proceeds thereof (R. 383-384). Petitioner denied ever having received the checks (R. 943). The amount involved is not sufficient to affect the outcome of the case.

or unreported, for the years in question, and (3) accountants' summaries and computations which disregarded and went beyond the evidence of record to estimate deficiencies in reported income for each of the years in question.

The Government's Case

The Government's principal witnesses were former employees of Petitioner at the Claremont Hotel and agents of the Internal Revenue Service. These witnesses described Petitioner's procedures for accounting for rental income as follows:

An incoming guest would sign a guest register card and the desk clerk would enter a room number, the date, and a rental rate on the card. The clerk would then transcribe the information from the register card to duplicate guest ledger sheets. If the guest paid in advance, the payment was entered on the guest ledger sheet and on a daily cash sheet (R. 341-342). The night clerk would enter the daily charges to each guest, including daily rental charges, on the guest ledger sheets each night (R. 596). Credits or allowances to guests were entered on the guest ledger sheets by Petitioner or by the desk clerk (R. 353-354). When a guest checked out, the desk clerk would total the charges, deduct any credits or allowances, and take payment for the balance. The payment was entered on the guest ledger sheet and the daily cash sheet, and the original guest ledger sheet was stamped "Paid" and given to the guest (R. 342). The daily cash sheet was checked and totaled each night by the night clerk, who also prepared a daily transcript showing charges and allowances to the account of each guest (R. 596). The daily cash sheets and the daily transcripts were then transmitted to the bookkeeper for appropriate entry in Petitioner's books (R. 263). The night clerk also prepared an allowance slip for each allowance entry ap-

pearing on the guest register sheet. These allowance slips were approved by Petitioner with a notation as to how the allowance was to be entered on the books and then transmitted to the bookkeeper (R. 264-265, 601-602). The effect of allowance entries on the books was to reduce the amount of recorded income (R. 284-285).

1. *Evidence Relating to Rental Income*

Allowances. Morgan, a former desk clerk, testified that she had never given a guest allowance credit (R. 171), that she had seen Petitioner use ink eradicator to make changes on the daily cash sheet (R. 150), and that she had seen evidence of changes on the guest ledger sheets where entries for cash receipts were eradicated and replaced by entries for allowances (R. 152). She identified, on guest ledger sheets for 1946 (Govt. Ex. 13), certain instances where cash receipt entries made in her handwriting had been eradicated and allowances in corresponding amounts entered (R. 157-166). She also testified, from daily cash sheets for 1946 (Govt. Ex. 11), that her entries on the cash sheets for each of these instances had been eradicated (R. 166-169). These instances totaled $698 for 1946.[3] By comparing other eradications on the 1946 cash sheets with entries in Petitioner's allowance journal (Govt. Ex. 9) she identified three more instances, aggregating $143, where cash receipts had been recorded as allowances (R. 245-248). The witness did not know what any of the allowances represented (R. 179, 249). She also located on the 1946 cash sheets a number of other instances where cash entries had been eradicated, but had no knowledge of what the removed entries represented (R. 197-200).

Newton, a former desk clerk, testified that on Petitioner's direction she had used ink eradicator to remove cash entries

[3] All money figures are to the nearest dollar.

on daily cash sheets and on guest ledger sheets, had replaced the eradicated cash entries on the guest ledger sheets with allowance entries in corresponding amounts, and had re-written one or two cash sheets omitting some of the original entries (R. 349-354, 423, 427-248). She identified, on guest ledger sheets for 1945-1947 (Govt. Ex. 15), specific items entered in 1946 in her handwriting where cash entries had been replaced by allowance entries (R. 357-362, 376-377). These items totaled $571. In each instance she found a corresponding eradication on the 1946 daily cash sheets (R. 365-366). She also found other eradications on the cash sheets for 1945-1947 (Govt. Exs. 10-12) and on guest ledger sheets which she was unable to identify (R. 363-364, 465-466).

This witness testified further that she had, at Petitioner's direction, originally entered some cash receipts on the guest ledger sheets as allowances, making no entry on the daily cash sheet (R. 364-367, 369-374, 390, 453-454, 480-481). From records she had made of these transactions (Govt. Exs. 45 and 48) and from corresponding guest ledger sheets (Govt. Ex. 46), she identified one item of $100 for 1945 and items for 1946 totaling $259. She also located on guest ledger sheets (Govt. Ex. 46) a number of other instances where allowances had been entered, but she had no knowledge of these transactions (R. 449-453).[4]

In each instance where Newton replaced a cash entry with an allowance entry or entered a cash receipt as an allowance she placed a corresponding amount of cash from the cash drawer in an envelope which was transmitted to Petitioner (R. 354, 367, 480).

In all instances where Newton had made allowance entries the guest had paid the full amount entered as an allow-

[4] This witness also testified to two other transactions (R. 464-465) covered here in the testimony of witness Morgan (R. 245-248).

ance, except in instances where an erroneous charge for garage service was corrected by an allowance entry (R. 355), or where the allowance was made pursuant to Petitioner's policy of crediting monthly guests $2.50 for the 31st day of any month (R. 411, 454-455). She did not know what the other allowances were for (R. 469), but testified that allowances would also be made for erroneous overcharges resulting from a mistake as to the number of guests in a room (R. 434).

Bauman, an expert witness, testified that he had by chemical process restored and photographed some of the entries which had been eradicated on the cash sheets. From his photographs (Govt. Exs. 52-62), and from Petitioner's allowance journal (Govt. Ex. 9), he identified instances where cash entries had been replaced by allowance entries which totaled $535 for 1945,[5] and $389 for 1946 (R. 549-572).

Vowles, former night clerk, identified one guest ledger sheet for 1946 on which he had, on instructions from Petitioner, wiped out a charge of $47 by an allowance entry (R. 616-617).[6] He testified also that for employees living at the hotel no charge was made on the guest ledger sheet (R. 634), that after OPA controls were lifted any guest who had paid in advance received the seventh day of the week free of charge, and that this would be reflected by an allowance entry in the guest's account (R. 626).

Twenty-one former guests testified that they had paid their bills in full and received no credit or allowance in instances where the full amount of the payments had been entered as allowances in the allowance journal (R. 485-540).

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[5] This omits one item in Bauman's testimony (R. 551) previously covered by witness Morgan (R. 164).

[6] Vowles also testified about another transaction (R. 617-618) covered by Bauman's testimony (R. 549).

These instances totaled $27 in 1945, $702 in 1946,[7] and $74 in 1947.

Thus, the testimony of all of the above witnesses covered instances where items of rental income were recorded as allowances, either originally or by alteration of original entries, in amounts aggregating $662 in 1945, $2,809 in 1946 and $74 in 1947.

Unreported Income. Vowles, former night clerk, testified that he made night rentals for one night only, on instructions from Petitioner, without making any entries on the cash sheet or the guest ledger sheets. These transactions would be recorded only on the guest registration card and payments received together with a special report to Petitioner were placed in a separate envelope and transmitted to Petitioner (R. 605-608). Vowles estimated that rentals handled in this fashion would average $20 to $30 a night (R. 611). He testified also, however, that he had kept a record of all these rentals from February 1945 until OPA controls were lifted, a time he fixed variously at July 1, 1947 and November 1, 1947 (R. 611-612, 633). He no longer had the record but his recollection was that it showed a total of "over $7,200" (R. 612). No effort was made to have Vowles allocate these rentals to the taxable years 1945, 1946 and 1947. Vowles testified further that all night rentals were entered on the cash sheet while Petitioner was away on trips in 1945 and 1946 (R. 610), that on November 1, 1947 he received written instructions from Petitioner's son (Govt. Ex. 63) to enter all future night rentals on the cash sheet, and that he did so thereafter (R. 613-614).

Restorations to Income. The Government's evidence also showed that some of the rental income covered by allowance entries and some of the night rentals originally unrecorded

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[7] This figure omits five instances (R. 501, 509, 517, 538, 540) previously included here in the testimony of other witnesses (R. 572, 361, 371, 359, 163).

were later restored to income accounts on Petitioner's books and that some income which was not restored to income accounts on the books was nevertheless reported on his tax returns.

Murta, the former bookkeeper, testified that she did not ordinarily see the guest ledger sheets (R. 291, 308) and that she made her entries on the books from the daily cash sheets, the daily transcripts and the allowance slips as they came to her (R. 264-265, 276, 320). She never made alterations in the entries on the cash sheets or on her books (R. 271-272), although she did at Petitioner's direction make additional entries on the cash sheets, carried over into her books, for "transient rents" and "overages" (R. 269-270, 316, 320; Govt. Exs. 9-12). She did not know what these entries represented (R. 270). Neither did she know what the allowances represented (R. 290-291), but Petitioner would mark the allowance slips to be charged to such accounts as "transient rent" and "cash shortage" and some of them may have represented bad debts (R. 281, 304, 330-332). Murta made no entries on the books which would return the allowance charges to income save as they might have been included in the entries for "transient rents" and "overages" entered by her on the cash sheet and in the books (R. 285).

Marx, an accountant formerly with the Internal Revenue Service, testified that he had gone over the daily cash sheets for 1945-1947 (Govt. Exs., 10-12) and had located cash entries for "transient rent" and "overages" added in Mrs. Murta's handwriting to the cash entries made by the desk clerks, which were carried into Petitioner's books and into the reported income on his tax returns (R. 762-764). He had found such entries totaling $1,466[8] for 1945, $5,106 for 1946 and $1,887 for 1947 (R. 763).

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[8] In fact, the cash sheets for 1945 show lump sum entries by Mrs. Murta on August 18, Sept. 12, Oct. 7 and Dec. 5 totaling $1,666.

Costello, an accountant, testified that his accounting firm had prepared Petitioner's 1945 tax return and that he had obtained from Petitioner's books and from Petitioner the information used in preparing the return (R. 678-68). In addition to what was shown on the books, Petitioner instructed Costello to report $1,400 as "cash over" for 1945 (R. 683) and that amount was so recorded on the worksheet which Costello prepared at the time (Govt. Ex. 67). Costello reclassified this item on the worksheet as "Wagering and other income" (R. 683-684) and it was reported in Petitioner's 1945 return (Govt. Ex. 1) as "Sundry, Wagering, etc." in addition to hotel rental income (R. 688).

Petitioner's 1946 return (Govt. Ex. 3) included a similar item of $2,000 for "Sundry, Wagering, etc." in addition to hotel rental income.

After receipt of all evidence relating to rental income the Government's case showed:

	1945	1946	1947	Total
Restorations to Income on books	$ 1,666	$ 5,106	$ 1,887	$ 8,659
Restorations to Income on tax returns	1,400	2,000	.....	3,400
Total Restorations	$ 3,066	$ 7,106	$ 1,887	$12,059
Less Income recorded as Allowances	662	2,809	74	3,545
Excess Restorations over Allowances	$ 2,404	$ 4,297	$ 1,813	$ 8,514
Less unrecorded night rentals				
Minimum estimate	?	?	?	$ 7,200
Maximum estimate	?	?	?	?
($30 per night but not every night)				

At this point, then, the Government had not shown a deficiency of reported hotel rental income [9] for any one of the years in question or for the entire period.

2. *Financial Statements.*

At the outset of the Government's case, Government counsel attempted to introduce various financial statements

[9] For 1947 the Government also claimed other items of unreported income not relevant here.

(Govt. Exs. 27, 31, 38) given by Petitioner to banks which showed a claimed net worth of $959,971 in May, 1946, $1,117,614 in February, 1947, $1,484,168 in May, 1947, $1,562,034 in November, 1947 and $2,474,927 in December, 1948. When defense counsel objected to the relevance of these statements, ruling on their admission was reserved (R. 127-128, 136-137).

After all of the Government's evidence relating to rental income had been received, the Court admitted financial statements given by Petitioner to internal revenue agent McCarthy in 1950 during the Government's investigation of Petitioner's 1945-1948 returns. These statements (Govt. Ex. 71), prepared by an accounting firm from books kept by Petitioner since 1945 and from his recollection of events prior to that time (R. 742), showed a net worth of $110,950 in 1938 and $28,022 in December, 1948. Government counsel then re-offered Government exhibits 27, 31 and 38 "as the basis for conflicting statements * * * given to Mr. McCarthy * * * as contrasted with statements given to the bank" and as relevant on the issues of intent, knowledge and "increase in net worth." Over defendant's renewed objections, these exhibits were also admitted (R. 740-741) and the total net worth figures shown on all of the financial statements were then read to the jury (R. 741-747).

3. *Summaries and Computations*

As its final witnesses the Government called accountants Marx and Holtberg of the Internal Revenue Service.

Marx testified that he had made summaries comparing allowance slips with checks deposited in the Bank of California and the National Bank of Commerce from "bank account deposit slips * * * now in evidence" (R. 764) for the Claremont Hotel account (R. 767). His summaries (Govt. Exs. 73A-73C) were admitted in evidence (R. 767).

Marx then read from one of them identifying an allowance slip with a check deposited in 1945 in the Bank of California, and asked if he should read all of the information on them. The Court stated, "Those exhibits are in evidence, Mr. Marx, so that anything that appears from them may be properly read," and advised defense counsel that, "I am merely telling Mr. Marx anything that appears on those papers is already before the jury and counsel may now direct attention to anything that is shown on them" (R. 768). Marx then read off allowance slips for 1945 totaling $1,990 and as to each slip testified there was a check deposited in like amount the following day in the Bank of California account (R. 769-770). He testified only to the total of $270 for check deposits in that bank corresponding to allowances in 1946 and to a similar total of $184 for 1947 (R. 771-772). He testified as to the total only of check deposits in the National Bank of Commerce account, the totals being $497 in 1945, and $30 in 1946 (R. 771). As Marx shifted in his testimony from check deposits to currency deposits, defense counsel said, "I think the jury should understand that these are in evidence. They speak for themselves. He is simply stating what the evidence shows." The Court replied, "Yes, Mr. Marx is merely making computations of exhibits that are already in evidence bringing out certain features about them that is proposed which is an entirely proper thing to do" (R. 774).

In fact, for the only summary whose total was of any significance, that covering check deposits in the Bank of California for 1945, there were no deposit tickets at all in evidence. Those tickets had been destroyed by the bank and could not be produced for this case (R. 132-133). Moreover, an examination of 1945 deposit slips for the National Bank of Commerce account (Govt. Ex. 29) fails to disclose

a single check deposited in the same amount as the allowances listed by Marx on Government Exhibit 73B.

Marx also testified that in making his comparison of allowances and deposits he had found two allowances to employees of the hotel for room rentals which seemed to him to be legitimate (R. 787).

Marx testified further that he had made a computation based on Vowles' testimony about unrecorded night rentals. After the Court had explained that Marx's computation was "based on Vowles' testimony" and "neither adds to it or subtracts to the fact of the matter," Marx testified that he computed 184 days from July 1, 1945 at $20 a day for a total unreported income in 1945 of $3,680, 365 days in 1946 at $20 a day for a total unreported income of $7,300, and 304 days to November 1, 1947 for a total unreported income in 1947 of $6,080 (R. 777).

Holtberg, the concluding witness for the Government, testified that he had been present in the courtroom throughout the presentation of the Government's case and had prepared a computation based upon "the documents and testimony in evidence" (R. 793-794). When defense counsel objected to the competency of the computation, Government counsel stated that it was to be introduced, "not as an exhibit, but for explanative purposes for the jury" and that it "would simply be demonstrative of the testimony" (R. 794). The Court ruled this permissible, copies of the computation were passed to the members of the jury (R. 794-795), and it was admitted in evidence (R. 825).

Petitioner's tax returns had reported net income of $10,021 in 1945, $16,549 in 1946 and a loss $13,972 in 1947. In his computation (Govt. Ex. 74), Holtberg purported to show unreported "additional net income" as follows:

	1945	1946	1947
Unreported room rentals	$ 3,680	$ 7,300	$ 6,080
Allowances	14,960	17,543	4,520
Other unreported income	295	.....	12,337
	$18,935	$24,843	$22,937
Less restorations to income on Petitioner's books	1,466	5,106	1,887
"Additional Net Income"	$17,469	$19,737	$21,050

After deductions and community property adjustments the computation showed a "tax deficiency" of $4,120 for 1945, $3,923 for 1946 and $597 for 1947.

Holtberg explained that his figures for unreported room rentals were based upon "the testimony of Mr. Vowles as computed by Mr. Marx" (R. 796, 799, 808), that his figures for allowances represented the total of all allowance entries which appeared on Petitioner's records in evidence (R. 797, 823) and that he gave Petitioner credit for restorations to income on the books "as Mr. Marx computed and testified to" (R. 797, 800-801). His computation did not give Petitioner credit for $1,400 reported as income although not recorded on the books in 1945 or for the $2,000 similarly reported in 1946.

The Court sought clarification on the 1946 computation where the sum of $24,842.83 was taken as the total of unreported night rentals and allowances and $5,106.25 was deducted as Marx's computation of lump sum restorations to income on the books, leaving an unreported income deficiency of $19,736.58:

> The Court: "Let me see if I understand it. From the figure $24,842 you have deducted or taken out all items as to which there is no evidence indicating that it was not a proper charge, is that in effect what you mean? Or to put it another way, the remainder of $19,736 is the total of all the items as to which there

is evidence indicating that the item was not properly carried, is that correct?"

The Witness: "That would be the net minimum figure, yes."

The Court: "Is that clear to all of you?"

Holtberg testified in support of his computation that he assumed that all allowances reflected in the Government's exhibits were illegitimate allowances representing rental income (R. 808), that he made no effort to ascertain how many employees lived at the hotel and were given allowances for their rent (R. 809), and that he "took the figures from the documents in evidence which does not include any allowances for employees as I understand it" (R. 822).

At the close of the Government's case the Court granted defendant's motion for an acquittal on Count Four and denied the motion on Counts One, Two and Three (R. 826-827).

Petitioner's Defense

Petitioner admitted that some rental income had been entered on the books as allowances and that some had not been recorded when received, but testified that all of such income had been reported in his tax returns (R. 901-902). He testified that when he acquired an interest in the Claremont Hotel in February, 1944, applicable OPA regulations fixed the number of rooms which must be rented at weekly and monthly rates rather than at the higher transient rates (R. 863-865), that he had filed an application with the OPA (Def. Ex. A7) to increase the number of rooms which he could rent at transient rates (R. 871, 886), and that, although the application was stamped approved September 2, 1944, he had received no notice of the approval until some time in 1946 or 1947 (R. 1006-1007).

Meanwhile, Petitioner testified, he anticipated the ap-

proval by instructing the clerks to charge on the basis of rentals requested in the application (R. 894), and the use of allowances to cover some of the rentals so charged was designed to avoid current OPA rental ceilings and the OPA limitation of five days' occupancy for transient rooms (R. 900, 912, 1005). Two witnesses who had rented rooms at the hotel on a monthly basis during the period of OPA controls also testified that they were billed at a rate in excess of the OPA ceiling but that the bills were reduced by allowances to the OPA rate which they actually paid (R. 873-874, 878-879).

Night clerk Vowles was instructed, Petitioner testified, to make rentals for one night only of rooms covered by paid reservations and of rooms of permanent guests who were temporarily away, and these rentals were not separately recorded in order to avoid difficulties with the OPA about double occupancy (R. 899-901, 1003, 1005). OPA regulation of Petitioner's rates ceased on October 23, 1947 and Vowles was instructed on November 1, 1947 to record these rentals thereafter on the cash sheet (R. 923).

Petitioner testified further that all rental income recorded either originally or by alteration as allowances and all of Vowles' night rentals which were not recorded at the time of receipt were later covered by lump sum entries on the cash sheets and on Petitioner's books and were reported in his tax returns (R. 899-902, 913, 922, 943, 999). The only exceptions were items totaling $1,400 in 1945 and $2,000 in 1946 which were not entered on the books but which were reported in the tax returns (R. 902, 1038).

Petitioner also testified that many of the allowance entries did not represent rental income, but represented cash shortages (R. 922), erroneous laundry, telephone, C.O.D. and other charges to guests (R. 908-909), erroneous charges based on a mistake as to the number of guests in a room

(R. 911), free rooms to celebrities and others who brought business to the hotel (R. 909), and free rooms to employees (R. 905). For employees living at the hotel, he testified, rent was charged on the guest ledger sheet, but later wiped off with an allowance (R. 906, 1027-1028). Reading from the allowance journal (Govt. Ex. 9) for July, 1946, he identified allowances to seven employees totaling $1,006 and testified that employee allowances averaged about $1,000 per month (R. 907-908, 944). Petitioner's daughter and witness Chapman, a maid at the hotel, identified four other employees who lived at the hotel (R. 840, 884).

Despite Petitioner's explanation that the financial statements given to revenue agent McCarthy (Govt. Ex. 71) were taken by an independent firm of accountants from his books and reflected book values where assets were carried at cost, while the statements to the banks (Govt. Exs. 27, 31, 38) made as a basis for loan applications estimated each principal asset at "what I wanted to get for it" (R. 930-937), Government counsel was allowed on cross-examination to range over Petitioner's financial affairs from 1919 to 1953 in an effort to show that the statements of net worth in 1938 and 1948 given to McCarthy were false (R. 968-991). During this detailed interrogation Petitioner was questioned about loans made in 1919 (R. 969, 974), assets in 1920 (R. 969, 973), a bankruptcy petition filed in 1925 (R. 970-973), loans made in 1927 (R. 977, 984), assets in 1928 (R. 981-984), a lawsuit against him for a $249 fuel bill in 1938 (R. 979, 985-986), loans made in 1938 (R. 977), assets sold in 1938-1941 (R. 977), and business transactions after 1948 (R. 987-991). In addition, Petitioner's income tax returns for 1940-1943, which had been excluded at the beginning of the Government's case (R. 89), were introduced by the Government and read to the jury (R. 949-964) and Petitioner was required, over objection, to testify about the contents of his returns for 1949-1953 (R. 992-993).

At the close of all the evidence defendant's motion for a directed verdict on Counts One, Two and Three was denied (R. 1050-1051).

Reasons for Granting the Writ

By affirming Petitioner's conviction the Court of Appeals has held that (a) a conviction for tax evasion may be based upon accountants' summaries and computations which include the accountants' opinions and conclusions on the interpretation, credibility and weight of testimony unrelated to accounting, and which also include computations supplying essential elements of the crime not based on evidence in the record, and (b) in a tax evasion prosecution where the net worth of the defendant is not in issue, the Government may introduce various statements of net worth made by defendant and attempt to prove that some or all of these statements are false as a means of persuading the jury that defendant's tax returns are false.

In so holding the Court of Appeals has violated standards limiting the use of summaries and computations established by the decisions of this Court in *Friedberg* v. *United States*, 348 U.S. 142 (1954) and *United States* v. *Johnson*, 319 U.S. 503 (1943). The Court of Appeals has also disregarded this Court's admonition in *Holland* v. *United States*, 348 U.S. 121, 125 (1954) that the technique of proof by financial statement, reluctantly sanctioned for cases where proof of net worth is essential to the Government's case, "is so fraught with danger for the innocent that the courts must closely scrutinize its use." By its decision here the Court of Appeals, without mentioning the matter in its opinion although it was clearly raised (R. 34-35) and argued on appeal, has permitted the use of that technique in a case where net worth was not in issue and where the only function of the financial statements was to prejudice the defendant and mislead the jury.

1. *The Improper Summaries and Computations.*

One element of the crime of tax evasion is an understatement of taxable income. *Smith* v. *United States,* 348 U.S. 147, 154 (1954). And where the prosecution is for more than one taxable year, there must be evidence of a deficiency in reported income "for each of the prosecution years." *United States* v. *Calderon,* 348 U.S. 160, 168 (1954). As we have shown (page 10, *supra*) without the use of the summaries and computations prepared by witnesses Marx and Holtberg the Government's case did not contain evidence establishing a deficiency in any amount for any one of the taxable years in question. Petitioner's conviction can be sustained only on Holtberg's assumption that all allowance entries represented unreported income or, alternatively, on Marx's assumption that unrecorded night rentals averaged $20 per night.

The summaries and computations based upon these assumptions were of crucial importance at all dispositive points in the case. Because they listed deficiencies of reported income in greater amount than was shown by the Government's evidence, and because they went beyond the evidence to allocate deficiencies to each year in question, the Government survived defendant's motions for an acquittal and for a direct verdict. Moreover, since the summaries and computations fixed the unreported deficiencies at amounts which exceeded the total income reported by Petitioner for each of the years 1945 and 1946 (pages 13-14, *supra*), their effect was to vitiate the defense that Petitioner's returns included all deficiencies claimed by the Government. In short, the summaries and computations, if accepted by the jury, removed all factual issues from the case on the element of understated income.

This Court has sanctioned the use in tax prosecutions of summaries and computations which do not embody opin-

ions of the Government witness who prepared the computation and which are confined to evidence "which has already been introduced at the trial." *Friedberg* v. *United States*, supra, at 144-145; *United States* v. *Johnson*, *supra*, at 519. The summaries and computations of witnesses Marx and Holtberg will not meet those requirements. The summaries and computations of these witnesses, qualified only as expert accountants, embodied opinions and conclusions on matters unrelated to accounting which should have been left to the jury for decision, and then only after it had heard Petitioner's evidence:

(a) Witness Vowles testified to the collection of unrecorded night rentals from February 1945 to November 1, 1947 except for two periods of unspecified duration, and estimated them at $20-$30 per night but stated that a written record of such rentals which he had kept from February 1945 to July or November 1947 showed a total of about $7,200. From the various choices available on this testimony Marx concluded, and Holtberg's computation was based upon the conclusion, that a $20 estimate was proper, and that it should be applied to every night from July 1, 1945 to November 1, 1947.

(b) Although Government witnesses identified allowances representing rental income which totaled only $3,471 for 1945-46, (page 8, *supra*) and testified that all allowance entries did not represent income (a fact later corroborated by Petitioner and his witnesses), Holtberg concluded that all allowance entries represented illegitimate concealment of income and treated total allowances aggregating $32,503 as income for 1945-1946 (page 14, *supra*).

(c) Although the testimony of Government witness Costello (later corroborated by Petitioner) indicated that income of $3,400 reported by Petitioner for 1945-

1946 as "Sundries, Wagering, etc." represented hotel rental income not recorded on Petitioner's books, Holtbeg's computation is based on the conclusion that the $3,400 figure represents something else.

Each of these conclusions involved an interpretation of ambiguous or inconsistent testimony, a rejection of testimony, or a weighing of conflicting testimony. To permit accountants to supply conclusions on the evaluation of testimony unrelated to accounting is as improper as to permit "professors of mechanics * * * to prove to the court or jury what is the proper or legal construction of any instrument of writing," *Winans* v. *New York & Erie R. Co.*, 62 How. 88, 101 (1858), or "to put the opinion of commercial experts in the place of that of the jury upon a question which was as well understood by the community at large as by merchants and importers." *Schmeider* v. *Barney*, 113 U. S. 645, 648 (1885). See also *U. S. Chemicals Co.* v. *Carbide Corp.*, 315 U.S. 668, 678 (1942) and the similar use of "experts" to interpret lay language now pending before this Court in *Gold* v. *United States*, October Term, 1956, No. 137. It is not the function of the accounting expert in a tax case to supply the jury with conclusions on the evaluation of lay testimony. *United States* v. *Ward*, 169 F. 2d 460 (C.A. 3, 1948).

The proper conclusion to be reached on each of the above matters was, like the conclusion embodied in a rejected computation proffered by the taxpayer-defendant in *Eggleton* v. *United States*, 227 F. 2d 493, 496 (C.A. 6, 1955) cert. den. No. 116 (October 8, 1956) "a matter of argument to the jury." But the accountants' conclusions were admitted and passed to the jury here as evidence, and while the jury was instructed that arguments of counsel did not constitute evidence and should be disregarded where they did not accord with the jury's recollection of the evidence (R. 1116-1117), it was instructed also that the summaries and com-

putations were admitted as "summaries of the evidence" which the jury was "entitled to consider" for its "assistance and convenience in considering the other evidence which they purport to summarize" (R. 1124-1125). The jury could derive assistance from the conclusions embodied in the computations of Marx and Holtberg only by abdicating its function and accepting those conclusions as its own.

The summaries and computations were not, moreover, confined to the evidence in the record:

> (a) Marx's summary of deposited checks for 1945 corresponding to allowance entries was not based on deposit slips in evidence so far as the Bank of California account is concerned. Perhaps he had seen those deposit slips before they were destroyed, but the desirability of confining the summary to evidence of record so that its accuracy may be tested is indicated by the fact that his summary of 1945 deposits in another bank account does not at all correspond with the deposit slips for that account in evidence.
>
> (b) The Government put in evidence to show that allowance entries totaling $32,503 were made on Petitioner's books in 1945-1946 and that $3,471 of this amount represented rental income. Holtberg, on the basis of nothing in the record and in disregard of the testimony of Government witnesses that some of the allowances did not represent income, treated the substantial difference between these two figures as rental income also.

Clearly these summaries and computations, unlike those employed in *Friedberg* v. *United States*, *supra*, and the *United States* v. *Johnson*, *supra* were not based on the evidence in the record. The requirement that such exhibits be confined to the evidence is applied to the taxpayer-de-

fendant. *Bernstein* v. *United States*, 234 F. 2d 475, 483 (C.A. 5, 1956), cert. den. No. 393 (November 19, 1956). It should be equally applicable to the Government. *United States* v. *Altruda*, 224 F. 2d 935, 942 (C.A. 2, 1955). Such summaries and computations, when not supported by documentary evidence or the testimony of persons with first-hand knowledge of the transactions upon which the computations are based, are "in the nature of hearsay," *Costello* v. *United States*, 350 U.S. 359 (1956), and inadmissible for that reason. Their admission would be grievously prejudicial in a case where the Government had produced proper evidence on all essential elements of the crime charged and was therefore entitled to go to the jury. Their use here to close a gap in the Government's proof on an essential element of the crime enabled the Government to secure a conviction on charges which should never have been submitted to the jury.

The error in admitting these summaries and computations was compounded by statements of the Court to or in the presence of the jury that the deposit slips upon which Marx based his computations were "already before the jury," that Marx was "merely making computations of exhibits that are already in evidence," that Marx's computation based on Vowles' testimony "neither adds to it or subtracts to the facts of the matter," (pages 12-13, *supra*), and that Holtberg's computation of unreported income was "the total of all items as to which there is evidence indicating that the item was not properly carried" (pages 14-15, *supra*). These remarks of the Court, like other conduct of the Court in *Steele* v. *United States*, 222 F. 2d 628, 630 (C.A. 5, 1955), could well be regarded by the jury as "investing these exhibits with an air of credibility as demonstrative evidence over and above, and independent of, the evidence which they purported to summarize."

The error was compounded again by an instruction which described the computations as "summaries of evidence" to be considered and used by the jury (R. 1124-1125) and by the further instruction that when an expert "is allowed to express opinions" his testimony "should be considered by you in connection with all other evidence in the case" (R. 1128-1129).

In *United States* v. *Johnson, supra,* this court sustained the use of computations where "The correctness or credibility of no materials underlying the expert's answers was even remotely foreclosed by the expert's testimony or withdrawn from proper independent determination by the jury" so that, "The jury could not possibly have been misled into the notion that they must accept the calculations of the Government expert" (319 U.S. at 519). On this aspect also, this case fails to meet the requirements of *United States* v. *Johnson, supra.* Even if the computations used here were free of opinions and conclusions and were confined to the evidence of record, this case presents the improper use of such evidence envisaged in *Holland* v. *United States, supra,* at 127-128:

> "There is great danger that the jury may assume that once the Government has established the figures in its net worth computations, the crime of tax evasion automatically follows. The possibility of this increases where the jury, without guarding instructions, is allowed to take into the jury room the various charts summarizing the computations; bare figures have a way of acquiring an existence of their own, independent of the evidence which gave rise to them."

2. *The Improper Use of Financial Statements.*

In net worth prosecutions, where the Government's case depends upon establishing an "opening net worth" at the

beginning of the taxable year and "increases in the taxpayer's net worth for each succeeding year during the period under examination," *Holland* v. *United States*, *supra* at 125, this Court has with great reluctance allowed the Government to prove opening net worth from financial statements of the defendant if adequately corroborated, *Smith* v. *United States*, *supra*; *United States* v. *Calderon*, *supra*, and has sanctioned also an inquiry into defendant's financial status for years antedating the taxable years in question to enable the Government to meet a defense that the financial statement for the opening period did not include substantial cash on hand. *Holland* v. *United States*, *supra*; *Friedberg* v. *United States*, *supra*. But it was recognized in *Holland* v. *United States*, *supra* at 128-129, that these practices, while essential to the use of the net worth method, were "fraught with danger" for the reasons, among others, that:

(a) "Although it may sound fair to say that the taxpayer can explain the 'bulge' in his net worth, he may be entirely honest and yet unable to recount his financial history. In addition, such a rule would tend to shift the burden of proof. Were the taxpayer compelled to come forward with evidence, he might risk lending support to the Government's case by showing loose business methods or losing the jury through his apparent evasiveness."

(b) "[T]he taxpayer's statements made to revenue agents in the course of their investigation * * * establish vital links in the Government's proof. But when a revenue agent confronts a taxpayer with an apparent deficiency, the latter may be more concerned with a quick settlement than an honest search for the truth. Moreover, the prosecutor may pick and choose from the taxpayer's statement, relying on the favorable

portion and throwing aside that which does not bolster its position."

It was no part of the Government's case here to establish, and the Government did not attempt to establish, Petitioner's "opening net worth" on January 1, 1945 or his net worth at any other time. Its case depended entirely upon, and its efforts were confined to, proof of specific items of unreported income for the taxable years in question. Use of income statements for those years might have been relevant to the issues; use of the balance sheet type of net worth statements here employed was not. Use of the dangerous techniques permitted of necessity in net worth cases served here only to prejudice Petitioner and inflame the jury, not to aid in the proof of the Government's case.

The Government did not use the financial statements given by Petitioner to revenue agent McCarthy to establish a net worth figure. Instead of attempting to corroborate those statements, the Government sought to discredit them, and this not for the purpose of establishing a different net worth figure but solely for the purpose of proving them false. Use of the statements for this purpose provided a pretext for introducing also financial statements which Petitioner had given to his banks and which the Government could contend were inconsistent with the statements given to revenue agents. On cross examination of Petitioner by Government counsel a search for further inconsistencies led to a detailed inquiry into Petitioner's financial affairs for 26 years preceding and five years following the years in question.

Government counsel contended that the financial statements were relevant substantive evidence on the issues of "intent and knowledge" (R. 740) and the Court instructed the jury that they might be considered as bearing on intent,

knowledge and credibility (R. 1123-1124). But obviously the making of these statements of net worth in 1950, even if they were false, constituted conduct too dissimilar from the acts charged to show a "consistent pattern of conduct" relevant to the question whether the Petitioner knew in 1945-1948 that his income was not fully reported or to the question whether Petitioner intended in 1945-1948 to evade his taxes. *Nye & Nisson* v. *United States*, 336 U.S. 613, 618 (1949); *Lloyd* v. *United States*, 226 F. 2d 9, 18 (C.A. 5, 1955). In a tax prosecution based on proof of failure to report specific items of income, evidence of false accounting on matters not relevant to the items in issue tends "to obscure the issue and to permit conviction on the general character of the defendant." *Hartman* v. *United States*, 215 F. 2d 386, 393 (C.A. 8, 1954).

The Government suggested no way in which the statements could be used to aid the jury in resolving questions of intent or knowledge. Instead it argued only that the alleged inconsistencies in the financial statements and in Petitioner's testimony about them tended to show that Petitioner was "attempting to make another false statement to the Government agencies, an attempt to convince the Government that his false returns were true" (R. 1091), and that "all of these things go to what you can judge is this man telling the truth?" (R. 1093). And the jury was told repeatedly by Government counsel that "if you find that he is not telling the truth in anything you can find he is not telling the truth at all" and "if you disbelieve him in anything you can disbelieve him when he says the money went back on" (R. 1094, 1096, 1098). It would have been no more nearly relevant to the crime charged, though perhaps not as prejudicial to the defendant, to show that he had made false statements to a policeman in an attempt to avoid receiving a ticket for traffic violation.

Obviously the Government did not use the financial statements to prove that Petitioner's tax returns for the years in question were false. It used them solely for the purpose of attempting to establish that Petitioner had made false statements on collateral matters not relevant to any fact in issue and that his testimony in this case should not be believed for that reason. This use of the statements for impeaching purposes was manifestly improper. *Hartman* v. *United States, supra; Cwach* v. *United States,* 212 F. 2d 520, 530 (C.A. 8, 1954); *Shanahan* v. *Southern Pacific Co.,* 188 F. 2d 564, 568 (C.A. 9, 1951); *Despiau* v. *U. S. Casualty Co.,* 89 F. 2d 43, 46 (C.A. 1, 1937); *Dillard* v. *United States,* 141 Fed. 303 (C.A. 9, 1905); 3 *Wigmore, Evidence* (3d Ed., 1940) Sections 1020-1022. Such use converts the techniques allowed by this Court despite the attendant hazard of prejudice to the defendant, in cases where they are essential to proof of the net worth issue, into techniques employed solely for the purpose of prejudicing the defendant in a case where net worth is not in issue.

Conclusion

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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DECEMBER, 1956.

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 14,801

Nov. 14, 1956

BILL CORBETT, Appellant,

vs.

UNITED STATES OF AMERICA, Appellee

Appeal from the United States District Court for the Western District of Washington, Southern Division

Before: ORR, Circuit Judge, CHAMBERS, Circuit Judge, and TOLIN, District Judge

TOLIN, District Judge:

After trial in the District Court defendant was convicted of Counts One and Two of a four-count Indictment which charged four separate violations of Title 26, U.S.C., Sec. 145(b) [wilful evasion of income tax.] The District Court dismissed Count Four, and the jury acquitted defendant of Count Three.

Among the grounds urged for reversal is the familiar one that the Court erred in denying defendant's motion for judgment of acquittal. The basis for the motion was insufficiency of the evidence. In asserting this ground, appellant urges a different view of his earnings than he related before indictment to prospective purchasers of his business. They, in turn, as witnesses, recalled defendant's narrative of current affluence during the indictment period.

Defendant's income during the years here in question [10]

[10] Count One, 1945; Count Two, 1946.

was derived principally from his operation of the Claremont Hotel in Seattle, Washington. Dewey Metzdorf, a prospective purchaser of the Claremont, testified that appellant had told him during 1946 that the hotel was netting $86,000.00 per year. Appellant reported on his tax return for 1945 (filed in 1946) that his net income for that year was $10,021.48, and for 1946 he reported $8,274.44. On another occasion appellant told a business visitor to the hotel of a technique relating to late night hotel rentals whereby, "I rent the rooms or my boy rents the rooms and we never make any accounting for tax purposes—it does amount to considerable."

The prosecution theory as to all counts was that the sum total of a large number of irregular practices in handling the finances of the hotel resulted in an understatement of income on the books of the hotel and that defendant knowingly and wilfully used the understatement as a correct one for tax purposes. The Government contended the true net income in 1945 had been $23,359.07 and the 1946 net income was actually $26,759.01. Summarizations of the evidence of income supported appellee's contention as to these amounts. Appellant's employees testified that it was their custom, at the oral direction of appellant, to enter records of allowances on the guests' accounts, whereas such allowances had not in fact been given the guests. In addition to a system of original false entry of such allowances on the books, there was testimony by employees that many records of the hotel were changed to convert original book entries showing payments of room rentals into entries showing allowances or credits to guests. These book alterations were made by use of erasures and ink eradicator, with new figures written in by, or at, the direction of appellant. By this method, that which originally had been recorded as "income" was changed to appear as "outgo". The testimony of the several witnesses to this method of falsely

creating records of allowances or credits supports the Government's claim that the recorded income of the Claremont was reduced $14,595.00 in 1945, and $17,542.00 in 1946. Expert examination of the records, by use of a fuming process which partially restored and made visible the original entries, corroborated the employees' testimony of extensive entry alterations. One of the employees who assisted appellant in his changing of records testified extensively to what had been done, and further testified that appellant told her she was as guilty as he. In addition to large scale use of this system, many payments of room rentals went directly to appellant without having any book record made of the receipt of the money. Two clerks and a bookkeeper testified to operation of these systems.

Appellant claimed that the entries of "allowances" to guests correctly reflected the frequent granting of brief free rent as a good will gesture to a permanent guest or a courtesy to persons whose residence in the hotel would enhance its prestige.

Opposed to this exculpatory testimony of appellant was the testimony of many guests as to whom the records showed "allowances" but who testified that, on the contrary, there were no allowances in their cases but the accounts were paid in full.

Employees of appellant who testified that they had followed his instructions in such manipulations, segregated large numbers of the hotel records which they asserted were of this false character.

A night clerk also testified to withholding from any record whatever, those lodgings rented during late night hours. The monies collected from this class of rental were handed to appellant each day in an envelope. The same clerk testified to similar handling of rentals collected from servicemen who patronized a one-dollar per cot service for the use of sleeping facilities on the hotel mezzanine.

This testimony attributed considerable additional income to defendant. The exact amount is uncertain because the employee witness stated it by estimates. By any of the methods used by him to compute this sum, a substantial unreported income was related. Either the improper allowance method, or the failure to report night rentals would in itself establish an income higher than that reported.

During the giving of testimony by Government agents in which written computations and summaries were used, there were frequent defense objections to the use of summaries, and the District Court as frequently pointed out to the jury that the agents' testimony in this field was not the primary evidence but a summary of other evidence.

In its very complete and readily understandable instructions, the Court referred to the agents' summaries in this way:

> "There have been admitted in evidence certain exhibits, variously referred to here as schedules or summaries. Strictly speaking these exhibits are not received as evidence themselves, but are admitted as a summary of the evidence admitted in the case and the summaries are admitted only for your assistance and convenience in considering the other evidence which they purport to summarize. Exhibits of this nature are permitted where they are based upon voluminous books, records or documents, but you are reminded that it is the books, records and documents which are the evidence and the summaries are admitted only to assist you in considering the evidence, and for that purpose you are entitled to consider them."

Despite this formal instruction in the charge and appropriate cautionary comment by the Court while the summary evidence was being received, it was emphatically urged on

this appeal that the allowance of testimony of summaries invaded the province of the jury. It is also claimed that the summaries are incorrect.

Computation and summaries by expert accountants has long been allowed for the use of juries in this type of case.[11] It was specifically approved by the Supreme Court in *United States* v. *Johnson,* 319 U.S. 503, 63 S.Ct. 1233, 87 L.Ed. 1546. Among safeguards which must be applied are procedural methods which bring before the jury the basic evidence which is summarized; also that broad scope of cross-examination be permitted in order that the accuracy of the account's summary may be tested. It must be made clear to the jury that such testimony and charts are but summaries of other evidence and that the jury should examine the basis upon which summarization rests, for it is not primary evidence at all but, instead, a gathering together and accounting classification of primary evidence.

In *United States* v. *Johnson,* 319 U.S. 503, the Supreme Court, in upholding this type of evidence, said:

> "* * * No issue was withdrawn from the jury. The correctness or credibility of no materials underlying the expert's answers was even remotely foreclosed by the expert's testimony or withdrawn from proper independent determination by the jury. The judge's charge was so clear and correct that no objection was made, though, of course, there were exceptions to the refusal to grant the usual requests for charges that were either redundant or unduly particularized items of testimony. * * *".

That language applies equally well to this case. The argument to this Court that the summaries were incorrect or

[11] Barcott v. United States, 169 F. 2d 929; Gendelman v. United States, 191 F. 2d 993; Remmer v. United States, 205 F. 2d 277.

were not supported by evidence, asks this Court to reassess what was, and always is, the jury's duty to examine and reject or accept. The record in this case shows a careful compilation in court of the foundation material before reception of a summarization by the accountant.

Among the summaries was one by which the Government sought to trace some of the amounts of money from defendant's original records into deposits of equivalent amounts in his bank account. The investigating agent testified in part from an examination of bank deposit slips but all of the deposit slips relating to Count One were not in the mass of documentary evidence because a destruction of old records procedure had been employed by the bank in the usual course of disposition of old records.[12] The checking of bank deposits equal in amount to funds made available by the false hotel income recording system was also an enumeration of the details of false entries and alteration of the hotel records which were in evidence. Appellant overlooks this dual function of the expert witness testimony and claims error in that the witness testified to the content of bank records which were not in evidence. In actuality, this was a small portion of a considerably larger analysis. It related to no more than a small amount of a total which would have been impressive without this disputed item. However, the use in the computation of bank deposit slips which had been destroyed before trial, was not improper. It has long been recognized that when a record has been destroyed, secondary evidence of its contents many be admitted.[13] That is what occurred in this case.

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[12] This was true as to Count One only. The deposit slips as to Count Two were complete.

[13] Goldsmith v. United States, 42 F. 2d 133; Callanan v. United States, 223 F. 2d 171; United States v. Phelan, 252 Fed. 891; United States v. White, 223 F. 2d 674; Wigmore, 3rd Edition, Sec. 1192.

Examination of the entire record convinces this Court that all required safeguards were applied in the reception of the expert summary testimony and that the basic evidence had been elaborately computed and accurately summarized.

The judgment should be, and is hereby, affirmed.

(Endorsed:) Opinion. Filed Nov. 14, 1956.

PAUL P. O'BRIEN,
Clerk.

(2818-3)